



### The tide came in, the tide went out

Yesterday the tide came in for the markets with another 4%+ rally. Today the tide went out as the markets dropped about 3%. For the two days combined we thought the market action was pretty good. We nibbled again today on a couple of stocks. I will come back to that in a minute.

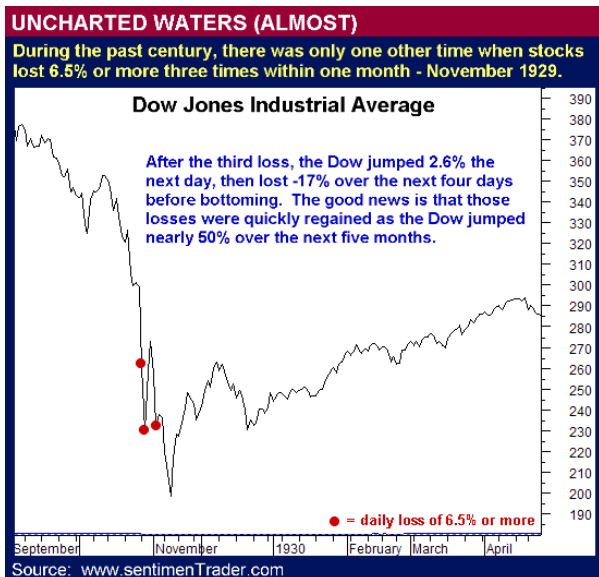
We have probably focused too much in our recent commentay on the stock market because it is the credit markets that are in charge right now. We know that, and so do you. No credit, no lending, no markets—it is just

that simple. The markets took heart from the fact that the LIBOR rate moved down yesterday—a sign that credit loosened a bit. That seems to be where yesterday’s rally came from. On the other hand LIBOR eased again today and the stock market sold off.

EVERYONE is watching LIBOR and wanting to see it come down. Today’s move, following a few days of minor decines was seen as a positive. EVERY MOVEMENT starts somewhere!



We were looking for a modest decline at the open of the stock market today. Yesterday’s rally seemed like a bit too much to us.



We bought very small positions in IBM and United Technologies (UTX) yesterday.

Today we bought small allocations of IBM, UTX, Coke (KO), American Express (AXP, and Caterpillar (CAT).

As of tonight we have added back a 7.5% allocation to equities in Hatteras; 5% in Fresnel, Halifax and Mendocino. We have added no equities to The New World, Pt. Reyes or the ETF model so far.

We are feeling a bit between the proverbial “rock and a hard place”. We have made our case for adding back equities to the models by citing extremes in the markets that point to a “tradeable bottom” being in. We have offered up the now famous Warren Buffett OP ED piece. We have shown you examples of bears turning into bulls (Doug Kass). We have cited

examples of extremely cheap stocks being for sale. All of these things argue for building back a sizeable equity position.

But we have been reluctant to add a lot to any of the models until we feel more secure that we aren’t being drawn into a 1929 style October crash, the likes of which we outlined for you on October 16<sup>th</sup>. We showed you this chart while describing Option #1 for getting back in. In Option #1 the market rallied briefly

after the third day it was down more than 6.5% in a single month back in 1929. Then it collapsed and went down another 17% before hitting the real bottom. On October 16 2008 we got a one-day rally after the third time it was down more than 6.5% on three single days in October 2008. THIS WAS ONLY THE SECOND TIME IN HISTORY THIS PATTERN HAS OCCURRED IN THE STOCK MARKET.

It looked like history was repeating itself. Since then the market has not acted exactly as it did in 1929, but the fact that we have sold off again keeps Option #1 "in play". It keeps us wondering if we will see one more dramatic sell off before all this is over, similar to the last 17% swoon that took place in 1929.

Yet we liked the tone of the market yesterday and today. We told you last time that a clear psychological shift seems to be taking place in the markets and that shift continues through today.

We are actually glad the market seemed to act rationally today by giving back part of yesterday's rally.

Tonight the market is liking Apple's (AAPL) earnings report as well as Yahoo's (YHOO). Both stocks are trading up substantially after reporting. Norfolk Southern Railroad reported minutes ago and it is up substantially after hours too. These may be indicators of a better day tomorrow.

Now for a word on how we are picking the stocks we are adding back to the models. Our primary candiidate are companes that have ALREADY REPORTED EARNINGS FOR THE PAST QUARTER AND MET OR EXCEEDED EXPECTATIONS, THEN OFFERED CREDIBLE GUIDANCE FOR NEXT QUARTER.

We are buying from a watchlist of stocks we have wanted to own. We are trying to avoid buying ahead of reported earnings. We want no surprises. We may have been tempted to buy AAPL ahead of their earnings report today, for example. If we had we'd be doing cartwheels right now. The stock is up 10% after hours as I write. But had their report not been good it could easily have been down 10%. We do not want that kind of risk in the models right now. We want to hear the earnings report, read it, digest it, react to corporate guidance and then make a measured decision to proceed. We are buying what we call "half-positions". By that we mean that we are buying half of what we eventually want to own. That gives us room to buy more if the stocks go down. It gives us room to average up if they go up.

More of the story tomorrow.

Paul Krsek  
MANAGING MEMBER & CHIEF INVESTMENT OFFICER  
K&A Asset Management, LLC  
702 Trancas Street, Suite 200  
Napa, California 94558

(707) 603-2672 Office  
(707) 486-7333 Cell  
(707) 224-2521 Fax  
[paul@kaassets.com](mailto:paul@kaassets.com)  
[www.kaassets.com](http://www.kaassets.com)

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K&A manages accounts with various histories and investment objectives. Various accounts may be managed differently from time to time.

Krsek makes frequent reference to the model portfolios called Hatteras, Mendocino, Halifax, Bonavista, Fresnel and The New World. During 2005 Paul Krsek was appointed Chief Investment Officer of K&A, and as such is responsible to make all trading and management decisions for all client accounts which are being managed according to a specific portfolio model. A description of each of our models can be found on our website at <http://www.kaassets.com/choices.htm>.

Not all accounts managed by K&A are "modeled" accounts. We strongly urge our clients to understand which model, if any, are being used to manage their accounts.

As of July 3, 2007 Lee O'Dwyer joined K&A as a portfolio manager. Paul Krsek and Lee O'Dwyer frequently discuss investment ideas, model portfolio strategies and the investment policies of K&A. But when it comes to the implementation of those policies Krsek is primarily responsible to manage the accounts that fit into each model portfolio description. He generally makes all final investment and trading decisions relative to those accounts that are considered to be "modeled." However, in Krsek's absence O'Dwyer does have the authority to trade all client accounts. He has been actively trading accounts in the various models since joining K&A.

From time to time K&A receives requests from clients to purchase securities that are not included in the model portfolio to which they are assigned. Effective May 24, 2006 K&A has encouraged clients to hold such securities in a separate account for the client. Because K&A is a "fee only" registered investment advisor" it charges its normal management fee for monitoring such securities in the separate accounts in which they are held.

K&A makes every effort to exclude securities that are 'requested by the client' from the modeled portfolio accounts.

The investment objectives of various accounts and models may be substantially different from one another. Therefore topics or investments mentioned in E-Ellumination may or may not apply to specific managed accounts and/or models.

Trades or adjustments to accounts mentioned in ELLUMINATION may or may not happen in every account managed by portfolio managers at K&A.

If you are not satisfied with the investment results in your account it is your responsibility to inform Krsek or Andreae and to discuss possible changes that can be made to the account to accommodate and satisfy your needs.

The assets held in managed accounts at K&A Asset Management, LLC may include stocks, bonds, cash, commodities, foreign exchange or mutual funds or exchange traded funds (ETF's), money market accounts or limited partnerships that represent the same. They are subject to market fluctuation and the potential for losses. The assets are not insured. The value and income produced by these investment products may fluctuate, so that an investor may get back less than they initially invested.

The portfolio managers at K&A Asset Management, LLC do not guarantee results.

Past performance should not be considered an indicator of potential future performance. If you do not consider yourself suitable, either emotionally or financially, to experience volatility and/or losses in financial markets, you should not invest.

From time to time Krsek lists the simple annual returns of the six model accounts in this newsletter. These accounts are "models" and do not represent the actual results accruing to individual accounts. Simple annual return does not represent "time weighted return" as reported individually to clients in their quarterly reports prepared using Centerpiece.

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Sincerely,

Paul Krsek  
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